No. [redacted] 63

IN THE

Supreme Court of the United States

OCTOBER TERM, 1938

V. L. LæTULLE, *Petitioner,*

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND SUPPORTING BRIEF

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May It Please the Court:

The petitioner, V. L. LeTulle, respectfully prays for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit at New Orleans, Louisiana, to hear this cause and to review the decision of the Circuit Court of Appeals in reversing the judgment of the United States District Court for the Western District of Texas, Austin Division. Petitioner respectfully shows to this Honorable Court:

1.

Summary Statement of the Matter Involved.

For the purposes of the appeal in the Circuit Court

of Appeals and the hearing in this Court there is no dispute as to the facts.

Petitioner was the sole stockholder of Gulf Coast Irrigation Company. On November 18, 1931, the Irrigation Company, in pursuance of a plan of reorganization, entered into on November 4, 1931 (R. 75), conveyed substantially all of its properties to Gulf Coast Water Company (R. 110) for $50,000 in cash and $750,000 in bonds, maturing in installments over a period of eleven years from January 1, 1933, to January 1, 1944, secured by a mortgage or deed of trust upon all of the properties so conveyed. (R. 113-176.) On November 21, 1931, the Irrigation Company was dissolved and distributed the cash and bonds and its few remaining assets to petitioner, its sole stockholder. (R. 65, 195.)

The Irrigation Company for the fiscal period involved (April 1—November 21, 1931) and petitioner and his wife (all their property being community property) for the calendar year 1931 in their income tax returns treated the exchange of the properties for cash and bonds and the distribution by the Irrigation Company as a tax free transaction under Section 112 of the Revenue Act of 1928 (Appendix A of appended brief) except as to the cash and other property received by petitioner on the dissolution of the Irrigation Company.

In June, 1934, the Commissioner held that this was a sale and not a tax free reorganization and assessed a tax against petitioner as the transferee of the Irrigation Company on that basis and further taxes

against petitioner and his wife individually for 1931 on the same theory (R. 66-68, 70-74), all of which petitioner paid. In the meantime petitioner's wife had died and it was agreed that he was the proper party, as her sole heir and survivor of the community, to prosecute the suits here involved. (R. 70.)

Petitioner in 1934 filed appropriate claims for refund with the respondent, and in September, 1936, having been unable to obtain any action on his claims, filed these suits, whereupon the Commissioner rejected them. (R. 18, 68, 74.)

Petitioner filed two suits, one to recover the tax assessed against him as transferee of the Irrigation Company (R. 2) and the other the additional taxes paid for himself and wife individually. (R. 19.) Both suits were consolidated into one cause. (R. 40.) The petitions refer to many matters other than this reorganization, due to the fact that the Commissioner had made other adjustments of petitioner's tax liability. The District Court held against petitioner on all issues except that of the reorganization, recomputed his liability on the basis of its being tax free (R. 196-200), and rendered judgment for petitioner for the overpayments made by him on that basis. (R. 59.) Petitioner did not appeal from that judgment. Consequently, on the appeal of the respondent, the only issue before the Circuit Court of Appeals was that involving this reorganization, whether it was a tax free reorganization or a taxable sale (except that respondent also complained of the District Court's overruling his motion for continuance).

Aside from question of the motion for continuance, the respondent in the Circuit Court of Appeals assailed the judgment of the District Court on one and only one ground, and that was that, since the Irrigation Company received only bonds of the Water Company but no stock, the transaction did not come within the reorganization provisions of Section 112. (See certified copies of brief of the Collector on file with this Court in this cause.) The Circuit Court of Appeals, following the decisions of this Court, overruled this argument as well as the complaint concerning the motion for continuance.

That Court, however, proceeded to reverse the judgment of the District Court upon a ground that had never been raised by the respondent or argued before that Court or the District Court. For an understanding of that Court's action it is necessary to refer back to certain details of the reorganization.

The Irrigation Company and the Water Company and LeTulle on November 4, 1931, executed a plan for the reorganization of the Irrigation Company's properties. (R. 75-91.) It recited that the Irrigation Company was the "owner of certain pumping plants, intakes, pumps, machinery, canals, flumes," and other irrigation properties "and prior to the conveyance hereinafter called for to be executed by the Irrigation Company to the Water Company, will be the owner of certain other land and irrigation properties" and provided for all of the properties to be later conveyed to the Water Company by the Irrigation Company for $50,000 in cash and $750,000 in bonds. (R. 76-77.) These other properties were at that time owned by

petitioner. At no place in this contract did petitioner bind himself to convey those properties to the Irrigation Company. The obvious reasons of the Water Company having him join in the agreement was to bind him personally to require the Irrigation Company to fulfill the contract (R. 87, par. XV), to warrant personally the Irrigation Company's titles (R. 87, par. XIV), and to enable the Water Company to obtain the good will attaching to the properties by petitioner's agreeing not to engage in the same business. (R. 84, par. VIII.)

Thereafter on November 7 the stockholders (R. 93-98) and the directors (R. 98-105) ratified and approved the plan of reorganization of November 4, and directed the officers and directors to dissolve the Irrigation Company as soon as the properties were conveyed to the Water Company. At that meeting the stock of the Irrigation Company was increased by $166,000, this stock being subscribed and paid for by petitioner by his conveying certain properties to the Irrigation Company, the record not showing of what those properties consisted.

On November 18, after the transfer on that day to the Water Company, the Board directed the officers to take such steps as might be necessary to dissolve the Irrigation Company immediately and to distribute all its assets in cancellation of its stock. (R. 105-109.)

The Circuit Court of Appeals on its own motion, in the last paragraph of its opinion (R. 287), stated that as to the properties owned by petitioner on November 4, this was a mere device resorted to by petitioner in

order to transfer his properties to the Water Company along with the other properties of the Irrigation Company, that he merely used the Irrigation Company as a conduit for passing the title and in substance this was a mere sale of his properties. That Court held that, therefore, only so much of the cash and bonds as represented the price paid for the properties owned by the Irrigation Company on November 4 was entitled to be protected from taxation and that as to the remainder the transaction was a taxable sale by petitioner. It remanded the case for further proceedings consistent with its opinion.

This defense was never raised by the respondent in the District Court, he having filed only a general demurrer and general denial (R. 18, 39), or in his brief in the Circuit Court of Appeals.

In due time petitioner filed his motion for rehearing on April 21, 1939 (R. 289), and prayed for oral argument on this point, but the Court on April 27, 1939, overruled the same. (R. 293.)

2.

Statement Disclosing Basis Upon Which It Is Contended This Court Has Jurisdiction.

Jurisdiction of this cause is conferred upon this Honorable Court by Judicial Code, Section 240, as amended; United States Code, Title 28, Section 347.

The judgment of the Circuit Court of Appeals was entered April 3, 1939 (R. 288), and petitioner's motion for rehearing overruled on April 27, 1939. (R. 293.)

3.

Questions Presented.

1. As the respondent did not invoke at any time the ground upon which the Circuit Court of Appeals reversed the judgment of the District Court, did that Court have authority to consider the same? Petitioner contends that this was a matter of defense that the respondent was required to raise affirmatively.

2. Was the Circuit Court of Appeals authorized in holding as a matter of law that the alleged action of petitioner was such a device as deprived him of the benefits of Section 112? We contend that no device was resorted to, and that on the record in this case the conclusion of that Court were wholly unwarranted.

3. The Circuit Court of Appeals having reversed the judgment in favor of petitioner on a theory that had not been advanced by respondent in either court, did that Court err in remanding the case to the District Court with instructions that further proceedings be had in accordance with its final and conclusive holding that, as to the properties at one time held by petitioner, the transaction was a taxable sale, without allowing the petitioner the opportunity to establish before the District Court by other evidence additional facts to combat this new and unexpected theory? We contend that under the circumstances petitioner has not had his day in court in reference to this theory of the Circuit Court of Appeals and, if the case should be remanded to the District Court, petitioner should have the opportunity to rebut by evidence the inferences drawn by the Circuit Court of Appeals.

4.

Reasons Relied on for the Allowance of the Writ.

The reasons relied on for the allowance of the writ are that the Circuit Court of Appeals has decided important questions of Federal law which have not been and should be settled by this Court, and that these questions have been decided in a way probably in conflict with the applicable decisions of this Court.

(1) The Circuit Court of Appeals held on its own motion that, where petitioner transferred certain irrigation properties of his own to the Irrigation Company for stock in that Company in a tax free transaction under Section 112(b)(5) of the Revenue Act of 1928, and the Irrigation Company thereafter exchanged all of its properties for cash and bonds of the Water Company in a tax free transaction under Section 112(b)(4), all in strict accordance and in conformity with the above provisions of Section 112, it had authority to hold, and did hold, without the point being raised by the respondent by defensive pleading, argument or otherwise, that petitioner resorted to this procedure as a scheme and device to avoid a tax upon himself that would have resulted if he had sold his individual properties directly to the Water Company. The transfer by petitioner to the Irrigation Company of these properties for stock in that Company and the transfer by the Irrigation Company of all the properties to the Water Company, were all in accordance with the provisions of Section 112 and under that section these were tax free trasactions. If the respondent desired to attack them on the ground

that it was a scheme and a device, as held by the Circuit Court of Appeals, the burden was upon him to raise that issue as defensive matter in the trial court, and as he did not do so, the decision of the Circuit Court of Appeals in reversing the trial court on that ground on its own motion is probably in conflict with the decisions of this Court in *General Utilities & Operating Company v. Helvering,* 296 U. S. 200, and *Helvering v. Salvage,* 297 U. S. 106, 109, and of the Circuit Courts of Appeal in *Budd v. Commissioner of Internal Revenue,* 43 F. (2d) 509, *Marshall v. Commissioner;* 57 F. (2d) 633, 634, and *Commissioner v. Neaves,* 81 F. (2d) 947, 948-9.

(2) Even if the ground upon which the Circuit Court of Appeals reversed the judgment of the trial court had been pleaded or otherwise raised by the respondent, that Court improperly held as a matter of law that this was a mere scheme by petitioner to sell his individual properties, using the Irrigation Company merely as a conduit and thus to avoid taxation that would have resulted if he had sold his individual properties directly to the Water Company. The decision of that Court is probably in conflict with the decision of this Court in *General Utilities & Operating Company v. Helvering, supra,* where the Company deliberately distributed certain stock to its stockholders and brought about a sale of that stock by them in order to avoid a corporate tax, and in *Helvering v. Minnesota Tea Company,* 296 U. S. 378, where the Tea Company deliberately transferred part of its assets to a new corporation and distributed the

stock of that Company to its stockholders, in order that, when it sold its remaining assets, it could say that it disposed of substantially all of its assets in a tax free reorganization, and the decisions of the Circuit Courts of Appeals in *Helvering v. Winston Bros. Company*, 76 F. (2d) 381, 383, *Chisholm v. Commissioner*, 79 F. (2d) 14, and *Commissioner v. Freund*, 98 F. (2d) 201, 207. As will be more fully pointed out in the brief in support of this petition, there were valid business reasons for handling the transaction in this manner and, if petitioner's individual properties had been sold directly to the Water Company, the income taxes that petitioner would have paid would actually have been less than his income tax liability as determined by the trial court in this case. Under those circumstances the Circuit Court of Appeals was not justified in the conclusions that it drew.

(3) Even if the Circuit Court of Appeals had authority to consider the ground upon which it reversed the judgment of the trial court, then, since its action was based upon a theory that was not before the trial court and which petitioner has therefore never had an opportunity to combat by additional facts and evidence, the Circuit Court of Appeals erred in holding as a matter of law that as to petitioner's individual properties the transaction was a taxable sale and in reversing the case with instructions to the trial court merely to proceed in conformity with its opinion. As will appear more fully from the brief in support of this petition, there were justifiable business reasons for the transfer of those properties to the Irrigation

Company and to support which the petitioner would have introduced evidence in the trial court if he had known that such a claim would be made. Under such circumstances the petitioner would be entitled on a new trial to present these additional facts under the decision of this Court in *Helvering v. Gowran*, 302 U. S. 238, and the Circuit Court of Appeals' decision in that respect is probably in conflict with said decision of this Court.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Fifth Circuit commanding said Court to certify and send to this Court on a day certain, to be therein designated, a full and complete transcript of the record of all of the proceedings in the Circuit Court of Appeals in said cause entitled *Frank Scofield, United States Collector of Internal Revenue for the First District of Texas, Appellant, v. V. L. LeTulle, Appellee,* No. 8948 on its docket, to the end that said cause may be reviewed and determined by this Court as provided by Section 240 of the Judicial Code, as amended, and that your petitioner may have such other and further relief or remedy in the premises as this Court may deem appropriate and in conformity with said provisions of the Judicial Code, and that on hearing be-

fore this Honorable Court said judgment of the Circuit Court of Appeals be reversed by this Honorable Court and such relief granted as is appropriate to the cause.

V. L. LeTULLE,
By W. E. DAVANT,
HOMER L. BRUCE,
Attorneys for Petitioner.

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BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

The Opinions of the Courts Below.

The District Court wrote no opinion but its findings of fact and conclusions of law are found at page 192 of the Record. The opinion of the Circuit Court of Appeals has not been reported but is found at page 283 of the Record.

II.

Jurisdiction.

Stated under heading 2 of the petition.

III.

Statement of the Case.

A full statement of the case has been given under heading 3 in the petition and in the interest of brevity is not repeated.

IV.

The Law.

The applicable provisions of the statutes are set out in Appendix A.

V.

Specification of Errors.

1. As respondent at no time raised as a defense by pleadings, evidence, argument or otherwise the grounds upon which the Circuit Court of Appeals reversed the judgment of the District Court, the Circuit Court of Appeals erred in considering them and in reversing the judgment of the District Court thereon.

2. The Circuit Court of Appeals erred in reversing the judgment of the District Court on the grounds set forth in its opinion, because the burden of pleading and proving those grounds as a defense to petitioner's suits was upon respondent and he at no time pleaded the same as a defense or offered any evidence in support thereof or in any manner interposed the same as a defense.

3. The Circuit Court of Appeals erred in holding

that the burden was upon petitioner to show not only that he had been illegally taxed but how much of what was collected from him was illegal and that he had failed to discharge this burden, because, having shown that the transactions involved came within the tax free reorganization provisions of Section 112 of the Revenue Act of 1928, the burden was upon respondent to plead and prove in the trial court that petitioner, as to the properties at one time owned by him, used the Gulf Coast Irrigation Company as a conduit to escape taxation and to plead and prove the other grounds upon which said Court reversed said judgment, and he did not plead, prove or in any way rely thereon as a defense.

4. The Circuit Court of Appeals erred in holding that, in so far as the properties transferred by petitioner to the Irrigation Company were concerned, the transaction was a sale by petitioner and that only so much of the consideration as represented the price of the other properties was entitled to be protected from taxation as arising from a reorganization.

5. The Circuit Court of Appeals erred in remanding the case to the District Court for further proceedings in conformity with its opinion without affording petitioner the opportunity to establish before the District Court by other evidence additional facts to disprove the theory upon which the Circuit Court of Appeals reversed said judgment.

ARGUMENT

Summary of the Argument.

Point A.

Petitioner in no way used the Irrigation Company as a conduit to avoid a taxable sale of his properties to the Water Company.

Point B.

The Circuit Court of Appeals had no authority to consider the grounds upon which it reversed the judgment of the trial court.

Point C.

Even if the Circuit Court of Appeals was authorized to remand the case to the trial court, it should have allowed petitioner to introduce such pertinent evidence as he might desire to rebut the conclusions on which the Circuit Court of Appeals reversed the judgment.

Points A and B

As these points involve so many related factors, they will be discussed together.

On November 4, 1931, the Irrigation Company owned pumping plants and a general irrigation system. Operated in connection therewith were certain other canals and lands which petitioner, the owner of all the stock of that Company, had never actually transferred to it. The Water Company desired to acquire the whole as an integral unit, but, as the Circuit Court of Appeals pointed out, had no independent resources with which to buy them or to pay off

the bonds that it gave as part of the purchase price. If the properties were profitable in their operation, the bonds would be paid off, otherwise the Irrigation Company and petitioner through it would have to take them back. The Irrigation Company, and on its dissolution the petitioner, received $50,000 in cash and $750,000 in bonds for these properties. The Commissioner held that this was a taxable sale, that the Irrigation Company received a taxable profit of $301,124.04 (R. 11), and that petitioner received on the liquidation of that Company a taxable profit of $473,209.49. (R. 22). Yet, all of this profit was only a paper profit, represented by these $750,000 of bonds, which as the lower court pointed out might never be paid off at all. But on this paper profit petitioner, individually and as a transferee of the Irrigation Company, was forced to pay a tax of $110,234.00 (R. 59), that being the overpayment for which the District Court gave him judgment.

Now, if petitioner had known in November, 1931, that he would on March 15, 1932, owe the Federal Government an income tax of $110,000 while still holding merely bonds of the character involved, it is obvious that the trade probably would not have been consummated. On the other hand, if the bonds should be paid off as they matured and his paper profit thereby converted into actual cash, then petitioner would be able and entirely willing to pay the appropriate income taxes each year on that part of the profit actually realized by him. That is exactly the attitude that Congress has for many years taken in regard to

such paper profit transactions through the tax free reorganization and installment sales provisions of the various revenue acts. For the purpose of enabling parties to make such purchases, sales, and exchanges of properties, it has long provided that the tax shall be payable only when the paper profit has been converted into cash, and the reorganization and installment sales provisions are in no sense loopholes for the evasion of taxes.

As stated, on November 4, 1931, the Water Company desired to purchase this irrigation system, the bulk of which was owned by the Irrigation Company and the balance by petitioner individually. There were any number of ways by which petitioner could have turned the transaction, and as will be later demonstrated, he could have so arranged it that he would have paid less taxes than he has actually paid. But there was one controlling factor making it imperative that the whole properties be transferred to the Water Company in one deed and that all the properties be security for each and every one of the bonds representing the purchase price. As the lower court pointed out, the Water Company had no resources other than these properties, and if it did not prosper, "the seller would most likely only get its property back."

Under the law of Texas, if the vendor of real property takes a mortgage or deed of trust back from the vendee to secure the unpaid purchase price, as was done in this case (R. 110-113, 113-177), the superior right to the land remains in the vendor until all of the purchase price has been paid. If default is made by

the purchaser, the vendor may either sue to foreclose his lien or may rescind the sale and take immediate possession of the property. *Dunlap v. Wright,* 11 Tex. 597; *Burgess v. Millican,* 50 Tex. 397; *Kennedy v. Embry,* 72 Tex. 387; *Crafts v. Daugherty,* 69 Tex. 477; *Jackson v. Palmer,* 52 Tex. 427. Under these circumstances, if all the properties were transferred to the Water Company by one deed, as was done in this case, all the properties would be subject to this vendor's lien to secure all the bonds and upon default in payment of any of the bonds, petitioner could rescind and take possession of all the properties as an operating unit and not be required to go through the delay of a foreclosure.

If, on the other hand, petitioner had done what the Circuit Court of Appeals held him to have done, that is, sold his individual properties directly to the Water Company for part of the bonds and had the Irrigation Company transfer the other properties for the remainder of the bonds, then part of the bonds would have been secured by a vendor's lien on one part of the properties and the other bonds secured by a vendor's lien on the other part, and even though a mortgage should be given upon all the properties as a unit to secure all the bonds, nevertheless, this right of rescission would have been materially impaired. In order for that right to have been preserved at all, it would have been necessary to designate which bonds were issued for the Irrigation Company's properties and which for petitioner's so-called individual properties. If the Water Company should keep current its payments, for example, on the bonds issued for the Irriga-

tion Company's properties, but default should be made as to the other bonds, petitioner's right of rescission as to the Irrigation Company's properties would not exist. On the other hand, where, as was done here, all the properties were transferred by one deed and all the bonds represented unpaid purchase money on all the properties, then if default were made in the payment of the bonds, petitioner could rescind as to the whole properties and retake possession without the necessity of a foreclosure.

Under the contract of November 4th, the Irrigation Company recited that it would own certain other properties prior to the contemplated conveyance by it to the Water Company, but nothing is said in that contract as to how the Irrigation Company should obtain them, and petitioner does not in any way rely upon that agreement as a reorganization of petitioner's interest in his individual properties, as the Circuit Court of Appeals in its opinion seems to indicate.

There were a number of ways in which petitioner could have transferred the properties to the Irrigation Company or have sold them directly to the Water Company and he would have incurred no greater tax liability than he did under the method actually employed. What he actually did, in order that the properties might all be transferred to the Water Company by one deed and be secured as a whole by one vendor's lien, was to transfer his properties to the Irrigation Company in payment of additional stock of that company, all of whose stock he owned. This was done in accordance with Section 112(b)(5) of the 1928 Revenue Act (Appendix A of this brief), and was a trans-

action in which neither gain nor loss under that section is recognized, and the Government has all the way through treated that transfer as a non-taxable transaction.

Petitioner could have accomplished the same results without increasing his income tax liability in any manner. He could have sold the properties to the Irrigation Company for cash or for notes at his exact cost and he would have had no tax to pay. He also could have done exactly what the Circuit Court of Appeals said he should have done, that is, sold these individual properties directly to the Water Company for part of the bonds and could have returned his profit on that sale on an installment basis under Section 44(b) of the 1928 Revenue Act, and paid his income tax as to that sale on an installment basis only as and when he collected the bonds. He could have had the first maturing bonds taken by the Irrigation Company and the later maturing bonds given for his own properties. Under that arrangement for the year 1931, the year involved, his income tax liability would have been actually less than his income tax for that year as determined by the District Court, and in which he has acquiesced. As the recomputation of his tax liability for 1931 is rather complicated, we respectfully refer this Honorable Court to Appendix B of this brief, from which it will be seen that for 1931, if petitioner had done what the Circuit Court of Appeals said he should have done, his tax liability would have been materially decreased. What his tax liability would have been during the succeeding years, neither the Circuit Court of Appeals nor anyone else can say, for that would depend

upon so many unknown factors, whether the bonds would be paid off, what other income or losses he might have from other business, and a variety of others.

It is clear, therefore, that the Circuit Court of Appeals was not in any way justified in holding that petitioner used the Irrigation Company as a conduit to avoid a taxable sale and therefore reversing the trial court's judgment.

But even without the foregoing considerations, the decision of the Circuit Court of Appeals is in conflict with those of this Court in *General Utilities & Operating Company v. Helvering*, 296 U. S. 200, and other cases. There the Southern Cities Utilities Company approached the General Utilities Company to buy from the latter stock that it owned in Islands Edison Company, but General Utilities Company refused to sell solely because of the resulting tax upon it. For the sole purpose of avoiding this tax, it proposed to distribute the stock to its stockholders and have the Southern Company buy it from them. The two companies thereupon worked out the terms upon which the Southern Company would buy from the stockholders and the plan was consummated. As against the affirmative contention of the Commissioner that this was a scheme to avoid the corporate tax (pages 29 to 38 of his brief in this Court), this Court upheld the transaction. Again, in *Helvering v. Minnesota Tea Company*, 296 U. S. 378, the Tea Company had an opportunity to sell part of its assets for cash and stock, but, for this to partake of a tax free reorganization as to the stock, the transfer must be of substantially all of the assets of the Tea Company. To meet this re-

quirement, that Company first transferred all its other assets to a newly organized subsidiary for all of its stock, which it immediately distributed to its stockholders. It thereupon concluded the originally contemplated sale of all its remaining assets and came within the statutory requirement of "substantially all of its properties." [See dissenting opinion of Judge Woodrough, 76 Fed. (2d) 797, at 803.] Nevertheless, this whole transaction was approved.

Petitioner merely followed the exact provisions of the Revenue Act, and even if he had thus reduced his income tax liability, the respondent would have no ground of complaint, for as this Court said in *Gregory v. Helvering,* 293 U. S. 469:

> "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. United States v. Isham, 17 Wall. 496, 506; Superior Oil Co. v. Mississippi, 280 U. S. 390, 395-6; Jones v. Helvering, 71 F. (2d) 214, 217."

Although the lower court did not cite the *Gregory case,* it apparently attempted to bring the present one within the exceptional facts involved in that case, but as was pointed out in the *Minnesota Tea Company case* at page 385 of 296 U. S., the *Gregory case* revealed a mere sham, whereas the record in the *Tea Company case* suggested nothing other than a bona fide business move, and we respectfully submit that the same is true in this case.

That the doctrine of the *Gregory case* will be ap-

plied only in clear cases is illustrated by *Helvering v. Winston Bros. Company*, 76 Fed. (2d) 381, 383; *Chisholm v. Commissioner*, 79 Fed. (2d) 14; and *Commissioner v. Freund*, 98 Fed. (2d) 201, 207, and the decision of the Circuit Court of Appeals is in conflict also with the decisions in those cases.

But, under the record, the Circuit Court of Appeals was not authorized to consider this point. We will review briefly the objections raised by the Government throughout this controversy. As shown on pages 66, 68, 70 and 74 of the record, petitioner introduced in evidence the original income tax returns, the letters from the Commissioner setting forth the ground on which he assessed the additional taxes and petitioner's claims for refund. All of these were before the trial court, but, since the respondent pleaded only a general demurrer and general denial (R. 18, 39) and the Commissioner and the respondent at no time contested petitioner's claims except on the one ground that no tax free reorganization resulted solely because the Irrigation Company obtained no stock in the Water Company, all of these documents were omitted from the record by the attorneys as they would serve no useful purpose on the appeal. However, those letters and instruments disclosed to the trial court, and would to this Court if in the record, that the Commissioner at no time from the original field audit of the returns in 1932 through the trial of the case, relied on anything except the above mentioned point. The trial court overruled it, and in the Circuit Court of Appeals, as shown by certified copies

of respondent's briefs in that Court which we have filed in this case for this Court's information, he again raised only the one answer to petitioner's claim. Yet the Circuit Court of Appeals, after overruling every contention of the respondent, *sua sponte* reversed and remanded the case and refused to allow petitioner the opportunity of any oral argument although in his motion for rehearing he respectfully requested that privilege. This action by the lower court was contrary to the fair standard reiterated by this Court in the *General Utilities & Operating Company case, supra,* at page 206 of 296 U. S.:

> "Always a taxpayer is entitled to know with fair certainty the basis of the claim against him."

In that case, the Commissioner appealed to the Circuit Court of Appeals on one ground but, as shown by 74 Fed. (2d) 972, actually raised in his brief the additional point upon which the Circuit Court of Appeals reversed the Board of Tax Appeals, that is, that there was a mere scheme to avoid taxation. In the present case respondent did not even inject the point into the case at all. Yet this Court in the *General Utilities case* properly held that the Circuit Court of Appeals erred in even considering the Commissioner's argument. We fail to see how the two decisions can be reconciled.

We submit that, where petitioner showed that he and the Irrigation Company had complied with the requirements of Section 112 of the Revenue Act, if the Government desired to resist his claim on the

ground that he had resorted to the alleged scheme, the burden was upon the Government to plead and prove that as an affirmative defense, and the decision of the lower court is in conflict with the decisions in the *General Utilities Company case, supra,* and in *Helvering v. Salvage,* 297 U. S. 106, 109; *Budd v. Commissioner of Internal Revenue,* 43 F. (2d) 509, 512; *Marshall v. Commissioner,* 57 Fed. (2d) 633, 634; *Commissioner v. Neaves,* 81 Fed. (2d) 947, 948-9, and many others. It is so well established that, where a plaintiff establishes a legal right, if the defendant relies as a defense upon fraud, devices or scheming, the burden is upon him affirmatively to plead and prove the same, that further citations are unnecessary.

Point C

The Circuit Court of Appeals held as a matter of law that, in so far as petitioner's individual properties were concerned, it was the same as if he had sold them to the Water Company, and if he desired to avail himself of Section 112 as to the Irrigation Company properties, the burden was upon him to show how much was paid for them and this he had failed to do, and remanded the case "that further proceedings may be had consistent with the opinion of this Court." As we construe that Court's order, the petitioner will on a new trial be conclusively bound by the opinion of the Circuit Court of Appeals and will not be allowed to introduce any evidence to overcome that Court's conclusions. The only factor that will be left in the case will be the determination of how much of

the $50,000 in cash and $750,000 in bonds were paid for the Irrigation Company's properties and for those of petitioner. If that can be determined, then the Circuit Court of Appeals admits that as to the Irrigation Company properties petitioner's taxes are to be computed on a tax free basis under Section 112. But if he fails to show that apportionment, then he will be entitled to no recovery whatsoever and the Government will keep the $110,000 of taxes that the District Court found had been illegally collected.

Without in any way being considered bound by judicial estoppel, we nevertheless frankly admit that up to this moment we have been unable to determine how petitioner could meet this impossible burden. All the properties were sold as a unit for the cash and bonds, and how any apportionment under the lower court's rule can be made we are at a loss at present to know. If that situation exists on the new trial, then petitioner will recover nothing. Petitioner will thus never have had his day in court upon the theory on which he will have lost out entirely.

Since the case was thus reversed on a theory developed by the Circuit Court of Appeals *sua sponte* and to the complete surprise of petitioner, its decision is in conflict with that of this Court in *Helvering v. Gowran*, 302 U. S. 238, where this Court held the proper practice under similar circumstances is for the case to be remanded, but with the opportunity afforded petitioner to establish before the trial court additional facts which would affect the result.

Conclusion.

It is respectfully submitted that this case is such as to call for the exercise by this Court of its supervisory powers, and we, therefore, respectfully pray that the petition for writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit be granted.

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APPENDIX A

REVENUE ACT OF 1928, CH. 852, 45 STAT. 791

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in Personal Property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of Realty and Casual Sales of Personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) SAME—GAIN OF CORPORATION.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by

each is substantially in proportion to his interest in the property prior to the exchange.

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to

be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

APPENDIX

This exhibit is in support of the statement on page 20 of the brief that, if petitioner had sold his individual properties directly to the Water Company, as the Circuit Court of Appeals held he did, he would have actually paid less income taxes in 1931 than the trial court found to be due.

Petitioner could have sold his properties to the Water Company for a small amount of cash and the remainder in the last maturing of the $750,000 of bonds. He would then have had the right under Section 44(b) of the 1928 Revenue Act to report his profit only as the bonds were paid from year to year. By taking only the later maturing bonds, he would have collected nothing on them in 1931 on account of his personal properties.

Since the properties were exchanged as a whole for $750,000 of bonds, it is impossible to say for how much he would have sold his individual properties, but typical examples may readily be taken.

On the appended table, the separate computations are as follows:

1. Column I is a reprint of the computation of his profit on the liquidation of the Irrigation Company and of his income taxes as made by the trial court (R. 197-199) showing a tax liability of $8,127.18 for himself of $16,254.36 for himself and wife.

2. Column II is on the basis of the Irrigation Company taking $281,954.89 of bonds and he in-

dividually, $468,045.11. This shows a tax liability of $6,231.83 or $12,463.66 for himself and wife, *or $3,790.70 less than the trial court found.*

3. Column III is on the basis of the Irrigation Company taking $500,000 of bonds and he individually, $250,000. This shows a tax liability of $7,268.81 or $14,537.62 for himself and wife, *or $1,716.74 less than the trial court found.*

4. Column IV is on the basis of the Irrigation Company taking $600,000 of bonds and he individually $150,000. This shows a tax liability of $7,534.13 or $15,068.26 for himself and wife, *or $1,186.10 less than the trial court found.*

We make the following explanations in connection th these computations:

1. On page 196 of the record the trial court set out e cost of the original 1,000 shares he had held for re than two years and of the 1,660 shares he obned in November, 1931, and apportioned to them as ditional cost the liabilities of the Irrigation Comny that he became responsible for when all of its sets were distributed to him. If he had sold his operties directly to the Water Company, he would ve had only the 1,000 shares and all of these liities would have been added as part of the cost of se shares, and corresponding changes have to be de in the computations.

2. Since he would have held only the 1,000 shares, his profit on the liquidation of the Irrigation Comny would have been subject to the lower capital gain te.

3. The profit realized on the payment of bond 1 to 8 in 1931 varies in each column, depending on th varying cost basis per $1,000 of bonds. Compar allocation and determination of cost basis by tria court on page 196 of Record.

4. In Column II the assumed allocation of bond between the Irrigation Company and petitioner i the same as the trial court's allocation on page 19 of the Record as between the 1,000 shares petitione owned and the 1,660 shares he received for his indi vidual properties. This is clearly disproportionat and for that reason the examples in Columns III an IV are set out. We believe that allocating as in Col umn IV, $600,000 of bonds to the Irrigation Com pany properties and only $150,000 to his individua properties is going too far the other way and allocat ing too small an amount of bonds to his properties But even there, it shows a smaller tax liability tha the trial court has found and to which petitioner ha acquiesced.

On the succeeding page are the computations.

PROFIT ON LIQUIDATION OF GULF COAST IRRIGATION COMPANY

	I		II		III		IV	
Consideration received:								
(a) Bonds:								
$150,000 at face value		$150,000.00	$150,000.00 at face value	$150,000.00	$150,000.00 at face value	$150,000.00	$150,000.00 at face value	$150,000.00
$600,000 at 75% of face value		450,000.00	131,954.89 at 75% of face value,	98,966.17	350,000.00 at 75% of face value	262,500.00	450,000.00 at 75% of face value	337,500.00
(b) Cash and property:								
A. Reported as ordinary dividend	$15,339.78		$15,339.78		$15,339.78		$15,339.78	
B. Cash (net)	42,950.43		42,950.43		42,950.43		42,950.43	
C. Notes receivable	33,421.96		33,421.96		33,421.96		33,421.96	
D. Real Estate	3,050.00	94,762.17	3,050.00	$94,762.17	3,050.00	$94,762.17	3,050.00	$94,762.17
TOTAL		694,762.17		$343,728.34		$507,262.17		$582,262.17
Less liabilities:								
E. Accounts payable	$55,000.00		$55,000.00		$55,000.00		$55,000.00	
F. Ad valorem taxes in dispute	6,787.85		6,787.85		6,787.85		6,787.85	
G. Bryan Jackson account	13,547.86		13,547.86		13,547.86		13,547.86	
H. Revenue stamps	375.26		375.26		375.26		375.26	
J. Income taxes of Gulf Coast Irrigation Co.	7,963.07		7,963.07		7,963.07		7,963.07	
K. Commissions	40,000.00	$123,674.04	40,000.00	$123,674.04	40,000.00	$123,674.04	40,000.00	$123,674.04
NET AMOUNT RECEIVED		$571,088.13		$220,054.30		$383,588.13		$458,588.13
Cost of stock in Gulf Coast Irrigation Co. (2660 shares)		$187,945.03	(1000 shares)	$58,407.12		58,407.12		58,407.12
PROFIT		$383,143.10		$161,647.18		$325,181.01		$400,181.01
TAXABLE PROFIT		94,762.17		94,762.17		94,762.17		94,762.17
Taxable profit allocated to 1660 shares held less than two years		59,137.30						
Taxable profit allocated to 1000 shares held over two years (capital gain)		35,624.87		94,762.17		94,762.17		94,762.17
COMPUTATION OF TAX								
Net income per return		82,296.38		82,296.38		82,296.38		82,296.38
Deduct (as included in return and included below):								
(1) Profit on liquidation of Gulf Coast Irrigation Company	$76,358.40		76,358.40		76,358.40		76,358.40	
(2) Dividend reported as ordinary income (part of liquidating distribution)	15,339.78	$91,698.18	15,339.78	91,698.18	15,339.78	91,698.18	15,339.78	91,698.18
DEFICIT		—$9,401.80		—$9,401.80		—$9,401.80		—$9,401.80
Add:								
(3) Reduction in loss on ranch	$3,245.00		3,245.00		3,245.00		3,245.00	
(4) Reduction in interest	6,906.17		6,906.17		6,906.17		6,906.17	
(5) Bad debts disallowed	1,773.73		1,773.73		1,773.73		1,773.73	
(6) Profit on liquidation of Gulf Coast Irrigation Company:								
Capital gain	35,624.87		94,762.17		94,762.17		94,762.17	
Ordinary income	59,137.30							
(7) Profit on payment in 1931 of Bonds 1 to 7:								
Amount received	$70,000.00		70,000.00		70,000.00		70,000.00	
Cost basis	26,045.53	43,954.47	45,204.60	24,795.40	25,491.20	44,508.80	21,452.90	48,547.10
(8) Profit on payment in 1931 of Bond 8:								
Amount received	$6,648.30		$6,648.30		$6,648.30		$6,648.30	
Cost basis	2,473.69	4,174.61 $154,816.15	4,293.34	2,354.96 $133,837.43	2,421.04	4,227.26 $155,423.13	2,037.50	4,610.80 $159,844.97
Taxable income on community basis		$145,414.35		$124,435.63		$146,021.33		$150,443.17
One-half to each spouse		72,707.18		62,217.82		73,010.67		75,221.59
Less capital gain (½ of $35,624.87)		17,812.43	(½ of $94,762.17)	47,381.09		47,381.09		47,381.09
Balance [illegible]ble at ordinary rates		$54,894.75		$14,836.73		$25,629.58		$27,840.50
Less:								
Dividends	$2,672.50		$2,672.50		$2,672.50		$2,672.50	
Personal exemption and credit for dependents	2,150.00	$4,822.50	2,150.00	4,822.50	2,150.00	4,822.50	2,150.00	4,822.50
Balance subject to normal tax		$50,072.25		$10,014.23		$20,807.08		$23,018.00
Normal tax 1½% on $4000.00		60.00		60.00		60.00		60.00
Normal tax 3% on $4000.00		120.00		120.00		120.00		120.00
Normal tax 5% on $42,072.45		2,103.61	(On $2,014.23)	100.71	(On $12,807.08)	640.35	(On $15,018.00)	750.90
Surtax on $54,894.75		3,645.27	(On $14,836.73)	56.73	(On $25,629.58)	554.07	(On $27,840.50)	708.84
Tax at 12½% on $17,812.43		2,226.55	(On $47,381.09)	5,922.64	(On $47,381.09)	5,922.64	(On $47,381.09)	5,922.64
TOTAL		$8,155.43		$6,260.08		$7,297.06		$7,562.38
Earned income credit		28.25		28.25		28.25		28.25
Income tax liability		$8,127.18		$6,231.83		$7,268.81		$7,534.13